

Internal Revenue Service

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Department of the Treasury

Washington, DC 20224

Third Party Communication: None

Date of Communication: Not Applicable

Person To Contact:

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CC:TEGE:EOEG:EO

PLR-144353-11

Date:

February 21, 2012

Legend

Fund =
Board =

City =
State =
Municipal =
Code =
Ordinance =
System =

Dear :

This letter responds to a letter from your authorized representative dated October 17, 2011, and subsequent correspondence submitted on behalf of the Fund, requesting a ruling that the Fund's income is excludable from gross income under Internal Revenue Code ("IRC") § 115. The Fund represents the facts as follows.

FACTS

The City is a State municipal corporation. The City is governed by its council. The council of the City enacted the Ordinance, amending the Municipal Code and creating the Fund in order to provide eligible retirees of the City and their dependents with health care in accordance with the terms of the City's health plans.

Pursuant to the provisions of the Ordinance, the trustees of the Fund are the members of the Board. The council of the City appoints four members of the public to serve on the Board. Two of the members of the Board are employees of the City, each generally from a different City department and selected by City employees who are members of

the System. One member is appointed by the council from those retired employees of the City, generally upon the recommendation of the retired members of the System. In the event of a vacancy on the Board: a successor public member shall be appointed by the council; a successor City employee member shall be recommended as successor at an election by the City employees; and a successor retired employee member shall be appointed by the council from among three candidates recommended by the retired employees.

Except for investment income, the income of the Fund consists solely of contributions from the City and the members of the System. The Ordinance provides, in general, that upon termination or dissolution no portion of the principal or income of the Fund shall revert to the City, or shall be used for or diverted to any purpose other than to provide health and welfare benefits to retirees and their dependents and to pay reasonable expenses of the Fund.

The Fund assets are only available to pay post-employment health care benefits of the employees of the City and their dependents. The Ordinance provides that the Board shall receive and accept all contributions and shall hold, reinvest, manage, administer, and distribute property and the increments, proceeds, earnings, and income solely to provide health and welfare benefits to retirees and their dependents. The Board may invest the Fund assets in such securities or property as the Board deems appropriate.

No private interests participate in or benefit from the operation of the Fund, other than for reasonable payment as providers of goods or services. The Ordinance provides that upon termination or dissolution of the Fund no assets remaining after payment of retirement benefits and expenses shall be distributed or revert to any entity that is not the State, a political subdivision of the State or an entity whose income is excluded from gross income under IRC § 115(1).

LAW AND ANALYSIS

IRC §115(1) provides that gross income does not include income derived from any public utility or the exercise of any essential governmental function and accruing to a state or any political subdivision thereof.

Rev. Rul. 77-261, 1977-2 C.B. 45, holds that income generated by an investment fund that is established by a state to hold revenues in excess of the amounts needed to meet current expenses is excludable from gross income under IRC § 115(1), because such investment constitutes an essential governmental function. The ruling explains that the statutory exclusion is intended to extend not to the income of a state or municipality resulting from its own participation in activities, but rather to the income of an entity engaged in the operation of a public utility or the performance of some governmental function that accrues to either a state or political subdivision of a state. The ruling points out that it may be assumed that Congress did not desire in any way to restrict a

state's participation in enterprises that might be useful in carrying out projects that are desirable from the standpoint of a state government and that are within the ambit of a sovereign to conduct.

Rev. Rul. 90-74, 1990-2 C.B. 34, holds that the income of an organization formed, funded, and operated by political subdivisions to pool various risks (e.g., casualty, public liability, workers' compensation, and employees' health) is excludable from gross income under IRC §115(1) because the organization is performing an essential governmental function. In Rev. Rul. 90-74, private interests neither materially participate in the organization nor benefit more than incidentally from the organization.

The Fund provides health benefits to retired employees of the City and their dependents. Providing health benefits to former public employees constitutes the performance of an essential governmental function within the meaning of IRC §115(1). See Rev. Rul. 77-261 and Rev. Rul. 90-74.

In addition, the income of the Fund accrues to the City. No private interests participate in or benefit from the operation of the Fund, other than as providers of goods or services. The Fund's dedication of its corpus or income exclusively for the benefit of the retirees and their dependents satisfies an obligation the City has assumed or been assigned with respect to providing health benefits to its employees. The benefit to the City's participating employees and their dependents is incidental to the public benefit. See Rev. Rul. 90-74.

Based on the information and representations submitted on behalf of the Fund, we conclude that:

Because the income of the Fund derives from the exercise of an essential governmental function and will accrue to a state or a political subdivision thereof, the Fund's income is excludable from gross income under IRC §115(1).

No opinion is expressed concerning the Federal tax consequences under any IRC provision other than the one specifically cited above. In particular, no representation is made that contributions or premiums paid on behalf of or benefits received by employees, former employees, retirees, spouses, dependents or others will be tax-free. This ruling concerns only the Federal tax treatment of the Fund's income and may not be cited or relied upon as to any matter relating to the taxation of accident or health contributions or benefits.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter.

This ruling is directed only to the taxpayer requesting it. IRC § 6110(k)(3) provides that it may not be used or cited as precedent.

In accordance with the Power of Attorney on file with this office, your authorized representative will receive a copy of this letter.

The ruling contained in this letter is based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for ruling, it is subject to verification on examination.

Sincerely,

Kenneth M. Griffin
Chief, Exempt Organizations Branch
(Tax Exempt & Government Entities)

Enclosure (1)